COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation Into the Provisions Of Default Service	)	**D.T.E. 02-40**

INITIAL COMMENTS OF THE

WESTERN MASSACHUSETTS INDUSTRIAL CUSTOMERS GROUP

The Western Massachusetts Industrial Customers Group ("WMICG") submit these initial comments in response to the Department of Telecommunications and Energy's Notice of Inquiry ("NOI") issued June 21, 2002, in this docket regarding the provision of default service. WMICG is an unincorporated group of large industrial customers located in the service territory of Western Massachusetts Electric Company ("WMECo") and includes General Electric Company, Plastics Division, MeadWestvaco Corporation, Schweitzer-Mauduit International, Inc. and Solutia Inc. WMICG submitted initial and reply comments in Pricing and Procurement of Default, D.T.E. 99-60 and many of its comments in that proceeding remain applicable to the current investigation in this proceeding.[1]

[1] WMICG made the following preliminary suggestions with respect to default service in July 1999: (1) a customer selecting an "averaged" default pricing option must remain on default service a minimum period of time equal to the "averaged" pricing option it has selected to avoid "gaming" the system; (2) there should be both fixed and variable pricing options; (3) there should be an option for customers with time-of-use metering to be billed based on the time-of-use; customers without time-of-use metering should be billed based on the rate class usage profile; (4) there should be a fixed administrative and general overhead factor determined by the Department yearly to be applied to wholesale electricity prices; (5) distribution companies should be allowed to collect its procurement costs only through the fixed administrative and general overhead factor and there should be no reconciliation of costs and expenses to procure electricity.

Most of the WMICIG entities are currently purchasing standard offer service from WMECo because they are served on rates or contracts that are not unbundled and require the customer to continue to purchase a bundled service to retain the benefits of the applicable rates, e.g. Rate PR, Rate I-1 or Rate I-3 or under contracts.

The Department in its June 21, 2002 Order in this docket stated that "the Department will evaluate our default service policies in the following three areas: (1) the price components to be included in default service rates, including administrative and bad debt costs and the effects of locational marginal pricing; (2) default service pricing options; and (3) procurement schedules and strategies." Order at 6. This investigation is timely and critical to the successful implementation of the benefits of electricity competition for all customers as the end of the transition period under the Electric Restructuring Act is rapidly approaching.

The Department in its Order noted that customer migration data compiled by the Commonwealth of Massachusetts Division of Energy Resources ("DOER") indicates that a competitive market has developed for large and medium commercial and industrial ("C & I") customers, but has not yet developed for small C & I customers and residential customers. Order at 5-6. The data does indicate an increase in large C & I customer purchases from competitive suppliers on and after July 1, 2001. This reflects the Department's structure of the standard offer charge and the Standard Offer Fuel Adjustment factor, the so-called SOSFA, implemented after the significant increase in fuel costs starting in April 2000 on an historic trailing basis. D.T.E. Order 00-66, 00-67, 00-70 (December 4, 2000). In the SOSFA Order the Department did not allow the distribution companies to charge the then current increases in fuel costs reflected in the market and pursuant to their standard offer power supply contracts. Rather the Department required the local distribution companies to defer significant fuel increases to administratively protect standard offer customers from the full costs being incurred and to stabilize the rates. While this may have been a politically attractive solution in a difficult situation when costs were rising , it created a mismatch of standard offer rates and market prices. When fuel prices decreased the recovery of the deferred costs created a standard offer price higher than market. This created an artificial incentive for customers to leave the standard offer.[2]

In the period when the standard offer rate exceeded market prices several competitive suppliers entered into contracts to supply large C & I customers power supply. The DOER data does not indicate the term of the contracts and thus it is not clear whether these large C & I customers will have a competitive market with many suppliers competing for their business when their current contracts end. Thus, the increase in the migration of large C & I customers may not indicate a fully functioning competitive market even for large C & I customers. WMICIG suggests that it is important that default service pricing and procurement be carefully reviewed to make sure that all customers, including large C & I customers, have a properly functioning competitive market.

Pricing Components of Default Service

WMICG believes that both the standard offer and default service prices should reflect all current generation costs and all energy-related administrative costs and bad debt costs now recovered in the distribution rates. Thus, the Department should properly unbundle all energy related administrative costs and bad debt expenses currently being recovered by electric distribution companies in the regulated distribution rates and transfer them to the standard offer and/or default rate. In Pricing and Procurement of Default, D.T.E. 99-60-B at 19 the Department rejected the inclusion of administrative costs and bad debt expenses in the default rate. This ruling must be reversed to properly unbundle electric rates as contemplated in the Electric Restructuring Act and to avoid requiring customers electing to purchase supply from a competitive marketer from paying twice for such costs -

[2] From about April 2000 until June 2001, the standard offer rate including the SOSFA for several distribution companies was below the market price for electricity. From July 1, 2001 through early 2002 when the fuel prices returned to prior levels, the standard offer rate plus the SOSFA exceeded the then market price for energy.

once in the distribution charges of the electric distribution company and a second time in the competitive market price from a supplier.[3]

WMICG suggests that the Department obtain the required information to determine the approximate amount of energy-related administrative costs and bad debt expenses in the current utility rates. Then the Department should establish a per kWh amount to be excluded from the distribution rates. This amount should be administratively established until the next fully allocated cost of service case filed by each utility.

In those distribution companies that will have more than one locational pricing point under the new NEPOOL locational pricing methodology approved by the Federal Energy Regulatory Commission, the default rate should reflect the additional cost in the areas where energy prices will be higher because of transmission congestion. If these costs are not reflected properly in the default rate, customers in high cost areas will be shielded from true market prices and be subsidized by other customers of the electric distribution company in areas without congestion. If the Department believes that such incremental costs cannot be reflected in the default rate the locational premium should be credited to any customer purchasing competitive supply in the congested areas to avoid distortion of the competitive market.

Default Service Pricing

Default service rates should reflect current costs and avoid transferring costs from one period to another. Currently the distribution companies procure default supplies for a six or twelve month period. Most RFPs for default service encourage fixed kWh pricing for the acquisition period. In some cases monthly pricing is accepted. This procurement method creates a cost based on the day bids for the power supply are made. Customers are protected from increased costs for the period of the bid.

[3] Currently the default price reflects only the wholesale price of electricity excluding all costs of acquisition. In addition, it does not reflect retailing costs incurred by the utility and included it its distribution rates in the vertically integrated model prior to the Electric Restructuring Act.

However, if prices go down the only option available is for the customer to leave the default supply for the competitive market. This creates an uneven and confusing market for power suppliers and customers. Increasing the length of the procurement period would make the default service rate more dependant on the price obtained by the distribution company on the date of the RFP and lead to a potential for more divergence of the default price from the market price during the term. This divergence is not based on customer load patterns or the relative efficiency of the competitive suppliers and the default price obtained by the distribution company, but by the structure of the default procurement and pricing policies. This does not create a sustainable competitive market. As noted above, the price for default service must include all energy-related administrative costs incurred by the utility and all bad debt costs which are currently included in the distribution rates. The distribution rates must be reduced by such costs at the same time they are initially added to the default prices.

WMICIG suggests that at least for large C& I customers the pricing and procurement of default supply should include a monthly adjustment in the price based on an accepted fuel or electricity price index. In addition for large C & I customers with time-of-use metering, pricing and procurement should be on a time-of-use basis. Such a pricing scheme will more properly reflect current costs and avoid average cost pricing which by its very nature creates subsidies among and between customers. If a customer wants to purchase a fixed price or different type of product it should do so in the competitive market from a competitive supplier.

Procurement Schedules and Strategies

WMICG suggests modifications to the current procurement procedure, at least for large C & I customers. The distribution company should acquire default service supply for this class on an on-peak/off-peak basis and pass this cost plus the administrative and bad debt costs on to the large C & I customers on a time-differentiated basis. Average ratemaking for this class creates a product that is more properly obtained from a competitive supplier.

The procurement process should reflect a price index that avoids a procurement price totally dependent on the date acquired which creates a greater possibility for deviation from the market price. Any customer that wants a longer term fixed price should select the appropriate term for its own purposes from a competitive supplier. For some customers this will be a six month or one year term and for others a longer term. Competitive suppliers can more properly provide this custom product to a customer. The Department should not establish a term of procurement or a portfolio approach with fixed prices as this will place the electric distribution company back in the power supply business contrary to the Electric Restructuring Act. Furthermore, such a procurement process will inhibit the development of a competitive market.

Conclusion

WMICIG appreciates the Department's review of default service pricing and urges the Department make the changes in the its policies for pricing and procurement of default service as outlined above. Appropriate changes in default pricing and procurement should be implemented as soon as possible. The Department should not wait until the expiration of the transition period in March 2005 to implement such changes. Transfer of energy-related administrative and bad-debt costs from the distribution rates should be included in the standard offer rates, if such rates are then available.

RESPECTFULLY SUBMITTED

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